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CABINET
MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

INDUSTRIAL ENERGY PRICES

Note by the Central Policy Review Staff

In E(81)59 the Secretary of State for Energy seeks colleagues' approval

- (a) a reduction across the board in derv duty of 3p/4p cost £40-55m;
- (b) remittance of fuel oil duty to selected consumers accounting for some 30% of HFO consumption, cost £40-55m;
- (c) selective assistance to certain electricity intensive consumers which could amount to over £50m in the current year. The NEDC task force reported that 5% of electricity consumers were intensive users at a severe disadvantage compared with corresponding users in France and Germany. This 5% take about half the electricity produced in the UK.

Policy Issues

2. These proposals mark substantial change of government policy in two areas. Proposals (b) and (c) above will result in discriminatory aid to selected parts of industry, albeit that the HFO remission is only discriminatory in order to obviate the technicalities of the Frigg contract; whilst (c) is also at variance with the principle of economic pricing of energy in that it proposes subsidising selected large users of electricity at prices below short run cost.
3. In considering these proposals Ministers will need to consider the general policy issue of whether the government wishes to support energy intensive industries at the expense of others. The CPRS believes that such support can only be justified if the energy intensive industries are thought to have good prospects in the UK long term without the need for subsidy. For this

to be true the UK must become a low cost energy producer, at least on a par with its main competitors in Europe, and strongly pursue policies aimed at this. For electricity in particular these need to include (a) provision of low-cost coal (b) programme for low-cost nuclear capacity, and (c) a highly efficient electricity supply industry. Only if an ambitious nuclear programme is carried through and underlying problems with the miners resolved will low-cost energy production begin to be possible.

4. The proposed support for heavy consumers of electricity raises the question of how long it will be needed. It is likely to be 10-15 years at least before low-cost nuclear and coal-fired generating capacity will be available on a sufficient scale. The supported companies if they are to maintain investment will need assurance of competitive energy supplies for this sort of period.

5. It has to be recognised that any form of energy subsidy may reduce the incentive for increased energy efficiency and better conservation. The market signals will point the wrong way; the incentive to invest in energy saving will be lessened.

Practical Difficulties

6. If Ministers believe that the changes in policy proposed by the Secretary of State for Energy are justified there still remain practical problems with the selective scheme:

(i) It is extremely hard to envisage, in the absence of a specific scheme from the Department of Industry, how satisfactory criteria will be established which do not lead to great annoyance and possible litigation. Arbitrary selection without criteria would probably be even more objectionable. Furthermore, consumers other than those sponsored by the Department of Industry will expect to be included (e.g. fishing and horticulture). How in practice will the line be drawn?

(ii) Provision of the proposed electricity subsidy appears beset

with legal problems. If it is given as a tariff reduction for some customers others will complain about undue preference. Legislation to avoid this will be controversial. If a subsidy payment is made direct to firms there could be opposition from the European Commission.

(iii) The consumers who continue to pay the fuel oil duty will in particular feel aggrieved and this will be difficult to assuage presentationally. Even if the technicalities of the Frigg contract could be explicitly explained such consumers would feel discriminated against. Industry regards the £8/tonne duty a mechanism whereby BGC scores twice at its expense; BGC can buy gas more cheaply because of the level of duty, it can then sell more expensively since its prices in parity with duty inclusive oil prices.

Recommendations

7. The CPRS believes that the Secretary of State's proposals which involve selective assistance should be pursued only if -

(i) Ministers are satisfied the United Kingdom can, within a reasonable period, become a low-cost energy producer; and

(ii) that the practical difficulties inherent in selection can be avoided or overcome.

Cabinet Office
6 April 1981